123 FERC ¶ 61,097
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

California Independent System Operator Corporation | Docket No. ER08-628-000

ORDER CONDITIONALLY ACCEPTING TARIFF REVISIONS

(Issued April 29, 2008)

1. In this order, the Commission conditionally accepts for filing the California Independent System Operator Corporation's (CAISO) proposed amendments to its current electric tariff (Tariff) and its Market Redesign and Technology Upgrade (MRTU) Tariff[1] to establish settlement charges that will be assessed to scheduling coordinators who fail to deliver on or "decline" pre-dispatch bids for import and export real-time energy, effective May 1, 2008, as requested. We also direct CAISO to submit a compliance filing reflecting the Tariff revisions discussed below.

I. **Background**

A. **CAISO's Pre-Dispatch Process**

2. CAISO "pre-dispatches" intertie bids for import or export energy at least forty-five minutes before each operating hour. To complete a transaction, a scheduling coordinator that receives a pre-dispatch from CAISO must respond by indicating that it intends to "accept" or that it "declines" (i.e., will not deliver). CAISO also considers a pre-dispatched bid as declined when a scheduling coordinator fails to respond to the pre-dispatch instruction.[2] A scheduling coordinator that accepts a pre-dispatched bid must then submit e-tag information for the CAISO Control Area scheduling system before the operating hour. Failure to do so is treated as if the pre-dispatch had been declined.

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[1] The MRTU Tariff will become effective upon implementation of CAISO's Market Redesign and Technology Upgrade.

[2] CAISO February 2008 Filing at 3.

3. CAISO explains that a high rate of declined pre-dispatched real-time market bids has the potential to result in operational problems or market inefficiencies, such as sub-optimal use of real-time incremental and decremental energy, reliability impacts, and the ability to thwart market rules if participants treat pre-dispatched real-time energy bids at the interties as a cost-free option to sell or buy energy.[3]

B. Excessive Pre-Dispatch Declines in California

4. Following an unusually high rate of "declined" intertie bids in the spring of 2007, CAISO determined that section 37.3.1.1 of its Tariff, which requires market participants to bid from resources that are "reasonably expected to be available," may not provide sufficiently clear guidance about expected conduct and consequences.[4] Concerned that the lack of clarity could either encourage infeasible bids or discourage legitimate bids, CAISO states that it decided to amend its Tariff.[5]

5. In October 2007, CAISO initiated a stakeholder process to assess options for addressing the problems caused by the excessive decline of pre-dispatched bids. After a series of proposals, comments, and conference calls with stakeholders, CAISO determined that a financial charge for declines in excess of a specific threshold would be an effective means for discouraging excessive declines of pre-dispatched real-time bids from imports and exports. In November 2007, CAISO issued a final proposal, which based the charge on its Uninstructed Deviation Penalty (UDP) provisions. Although there was no clear consensus from stakeholders on the details of the proposal, CAISO states that virtually all of the participants agreed that some sort of charge was appropriate.[6]

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[3] CAISO explains that while it has not actually experienced these problems to date, there were several occasions in the spring of 2007 when excessive declines threatened to deplete the available capacity of five-minute dispatchable resources. *See* CAISO February 2008 Filing at 4.

[4] Section 37.3.1.1 provides the following:

> Market Participants must bid and schedule Energy and Ancillary Services from resources that are reasonably expected to be available and capable of performing at the levels specified in the bid and/or schedule, and to remain available and capable of so performing based on all information that is known to the Market Participant or should have been known to the Market Participant at the time of bidding or scheduling.

[5] CAISO February 2008 Filing at 2.

[6] *Id*. at 5.

C. CAISO's Proposed Tariff Amendment

6. On February 29, 2008, CAISO filed the instant proposal. CAISO's proposed Tariff amendment adopts settlement charges, which are reflected in section 11.31, for declines of pre-dispatched import or export energy if scheduling coordinators fail to deliver on import or export bids during the trading month in an amount above 300 megawatt-hours (MWh) and 10 percent of their pre-dispatched import or export bids.[7]

7. In support of its proposed 10 percent threshold, CAISO explains that, its analyses concluded that setting the primary threshold exemption level at 5 percent (as proposed by some stakeholders) would jeopardize too much of the pre-dispatch incremental energy that is available to it -- possibly as much as 38 percent -- due to the possibility of scheduling coordinators refraining from bidding into the CAISO's markets. Thus, CAISO set the primary threshold exemption level at 10 percent, determining that these settlement charges will apply to all pre-dispatched bids that are not delivered for any reason, including dispatches that are declined due to failure to timely submit a valid e-tag, with no exceptions.[8]

8. Thus, under CAISO's proposal, a scheduling coordinator may incur a certain minimum level of declines during a trading month without incurring a charge. At the end of every trading month, CAISO will calculate each scheduling coordinator's declines, both in terms of absolute quantity and rate (as the percentage of MWh dispatched that are not delivered). The decline quantity and rate will be calculated separately for import and export dispatches.

9. A scheduling coordinator that exceeds the 300 MW and 10 percent thresholds will be assessed a charge, which will be calculated from the sum of the individual charges that apply to each decline of a pre-dispatched bid for import or export energy reduced to account for the declines that were within the exemption threshold.[9] In other words,

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[7] *See id*. at Attachment A, Tariff sections 11.31.1 and 11.31.2.

[8] *Id*. at 8. CAISO states that currently, a delivered import bid is paid (or charged, for exports) "as bid" (i.e., paid or charged its bid price). Under MRTU, accepted import and export bids will be paid or charged at the Hour-Ahead Scheduling Process (HASP) clearing price. A declined bid, on the other hand, is not otherwise settled - there is no payment or charge under section 11.

[9] These charges for individual declines will be based on the pre-dispatch price and the quantity declined, calculated as follows:

> Declined MWh quantity x maximum ($10/MWh, 50 percent of pre-dispatch price).

CAISO states, the sum of the individual charges would be multiplied by the MWh quantity of the scheduling coordinator's declined pre-dispatched bids minus the exemption threshold (the greater of the applicable thresholds) divided by the MWh quantity of the scheduling coordinator's declined pre-dispatched bids.[10]

10. CAISO also states in its transmittal letter that the amendment revises section 37.3.1.2 of the "'Enforcement Protocol'…to clarify that there will be no separate Sanction for violations of section 37.3 due to a Scheduling Coordinator's failure to deliver on pre-dispatched bids for import or export energy."[11]

11. CAISO seeks to make its proposed charge effective in its current Tariff on May 1, 2008, and in its MRTU, upon implementation of MRTU.

II. Notice and Responsive Pleadings

12. Notice of CAISO's February 29, 2008 filing was published in the *Federal Register*, 73 Fed. Reg. 13,876 (2008), with interventions and protests due on or before March 21, 2008. Timely motions to intervene were filed by the California Department of Water Resources State Water Project, Modesto Irrigation District, the Northern California Power Agency, and the NRG Companies.[12] Timely motions to intervene and comments were filed by Dynegy Power Marketing, Inc. (Dynegy), Pacific Gas and Electric Company (PG&E), and Southern California Edison Company (SoCal Edison). Powerex Corp. (Powerex); the City of Santa Clara, California and the M-S-R Power Agency (collectively, SVP/MSR); and Mirant Energy Trading, LLC, Mirant California, LLC, Mirant Delta, LLC, and Mirant Potrero, LLC (collectively, Mirant Parties) filed timely motions to intervene and protest.

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[10] CAISO February 2008 Filing at 9.

[11] *Id*. at 8. Specifically, CAISO proposes to revise section 37.3.1.2, "Consequences for Non-Performance" to state:

> A Market Participant that fails to perform in accordance with the expected conduct described in section 37.3.1.1 above shall be subject to having the payment rescinded for any portion of an Ancillary Service that is unavailable, *or if the Market Participant fails to deliver on an Hourly Pre-Dispatch bid for import or export of Supplemental Energy, it shall be subject to any charge that may apply in section 11.31*.

[12] The NRG Companies include NRG Power Marketing LLC, Cabrillo Power I LLC, Cabrillo Power II LLC, El Segundo Power LLC, and Long Beach Generation LLC.

III. Discussion

A. Procedural Matters

13. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,[13] the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

B. CAISO's Proposed Settlement Charge for Pre-Dispatch Declines

1. Comments

14. As owners of generation and users of the CAISO controlled grid, SVP/MSR request that the Commission deny CAISO's proposal, arguing that the problems CAISO identifies in its proposal do not warrant the solution that it seeks. SVP/MSR assert that CAISO essentially seeks a "cost-free option to sell or buy energy" by not paying scheduling coordinators for their pre-dispatch bids (i.e., CAISO will be able to reserve the energy that it needs at no cost to CAISO).[14] Instead, SVP/MSR recommend that CAISO consider paying a reservation fee or option premium.

15. First, SVP/MSR submit that CAISO's claims on gaming are flawed. They explain that the non-binding pre-dispatch bid system is very much like the physical bilateral market. For example, in the Intercontinental Exchange (ICE), a bid or offer can be changed or withdrawn up until the counter-party commits to accept the power; there is no period of time that the bid on ICE is subject to being executed that the bidding entity does not control. SVP/MSR explain that this is the nature of bids that are unsecured by a reservation fee or option premium. SVP/MSR conclude that CAISO's proposal would result in lost opportunity costs for the bidding entity.[15]

16. As an example, SVP/MSR point to a situation where a load serving entity (LSE) may have excess generation consisting of a peaking turbine and an already-running, but backed-off, combined cycle plant. The LSE would be willing to bid, on a non-binding basis, energy from its lower-cost combined cycle plant at a price near variable cost. However, if the LSE is required to make this energy available on a firm or binding basis, it has to assume that it may need to start its more expensive peaking turbine if it has a forced outage of another unit, mis-forecasts its load, or has a third party willing to pay something in excess of its variable cost. SVP/MSR argues that these potential costs will have to be reflected in the bid price to CAISO.

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[13] 18 C.F.R. § 385.214 (2007).

[14] SVP/MSR Protest at 10.

[15] *Id*. at 7-8.

17. SVP/MSR further argue that while declined pre-dispatches may result in sub-optimal use of resources for CAISO, penalizing scheduling coordinators for declines will result in the same concern for CAISO's neighboring control areas. They contend that, as in the example above, a non-binding bid will result in more instances where the least cost of serving load is achieved in the Western Interconnect, and not just the CAISO balancing authority area.

18. SVP/MSR also submit that imposing a penalty on pre-dispatched declines turns a non-binding bid into a binding bid, which will act as a deterrent to bidding and result in a shortfall of the energy that CAISO is trying to procure.

19. Finally, SVP/MSR argue that as more intermittent resources are added to California's electricity grid, such as wind and solar, the need for dispatchable reserves and flexible resources will become more critical. They suggest that paying a reservation fee or option payment to lock in pre-dispatch bids would likely result in a better chance of ensuring a reliable stack of dispatchable energy than would a penalty for declining a pre-dispatched bid.

20. While generally supportive of CAISO's proposal, PG&E and SoCal Edison assert that charges should be assessed to all pre-dispatch intertie declines except for those justified by uncontrollable events such as *force majeure* events, generator outages or transmission curtailments. PG&E characterizes as unpersuasive CAISO's arguments that: (1) it would be impossible to evaluate the circumstances of numerous individual declines; and (2) requiring a scheduling coordinator to honor its bid could discourage legitimate import bids and lead marketers to add unnecessary premiums. On the former argument, PG&E submits that CAISO will not have to independently evaluate each decline because the scheduling coordinators can be expected to report honestly. PG&E states that CAISO would be in a position to follow up with any scheduling coordinator who demonstrated a consistent pattern of declines. On the latter argument, PG&E contends that a scheduling coordinator would not face any charge for declining a legitimate bid as long as that decline is caused by forces beyond the scheduling coordinator's control.[16]

21. PG&E adds that if CAISO is right in its analysis that the ability to decline pre-dispatch bids without any cost is likely to harm the market and reliability, then the market is more likely to be helped by requiring scheduling coordinators to honor their bids if they are able to do so.

22. PG&E and SoCal Edison argue that to the extent that the Commission determines that a threshold decline rate is necessary, it should be no more than five percent. PG&E

[16] PG&E Comments at 7.

also suggests that CAISO should monitor the number of declined bids to consider whether the level of the charge should be increased.[17]

23. Powerex also recommends a five percent threshold, arguing that this level would approximate the amount of declines a scheduling coordinator may have to make because of circumstances beyond its control.[18] It contends that CAISO has not shown that 10 percent approximates this level of involuntary declines. Powerex argues that setting a 10 percent threshold decline rate would not significantly alter the amount of energy declined, but would instead increase the decline rate to the established threshold. Powerex and SoCal Edison submit that a 10 percent threshold will allow a significant amount of declines, which could leave substantial room for speculative behavior and reliability concerns. In particular, Powerex notes that a 10 percent monthly threshold does not address declines in hours of peak demand when CAISO may urgently need energy.

24. In support of the five percent threshold, Powerex also cites CAISO's analysis on pre-dispatch,[19] in which CAISO identified only 12 instances of real-time schedule cuts by CAISO during the October 2006 to November 2007 period due to reasons like unscheduled flow. CAISO found that, except in one instance, schedule cuts have a minimal contribution to the threshold limit, and that in this one instance, the schedule cut amounted to a six percent decline of decremental energy for a single market participant and less than a two percent decline of incremental energy for all other market participants.

25. Dynegy supports CAISO's proposal, but contends that the misalignment between CAISO's markets and the trading timelines employed by West's traders fundamentally contributes to declined pre-dispatched bids. It asserts that in the West, energy is traded in the half hour between the time a scheduling coordinator submits bids to the CAISO and the time the CAISO pre-dispatches those bids, which can create problems. For example, a scheduling coordinator may have a source lined up behind a CAISO import bid, submit that import bid to CAISO, but then lose the source prior to CAISO pre-dispatching that import bid. Dynegy concludes that future amendments to CAISO's markets should seek to address this problem, not merely impose financial penalties.

26. Mirant contends that power marketers provide critical liquidity to CAISO's real-time energy import/export market that will disappear unless the Commission increases

[17] *Id.*; SoCal Edison Comments at 2.

[18] Powerex Protest at 14.

[19] *See* CAISO Proposal on Declined Real-Time Import and Export Bids, Attachment E, at 6 (Nov. 30, 2007).

the 300 MWh exemption threshold.[20] Mirant argues that the 300 MWh threshold punishes behavior that is not penalized under the 10 percent exemption and is unsupported. For example, Mirant argues that a large scheduling coordinator submitting a 500 MWh bid at the beginning of a month that is pre-dispatched by CAISO but then suffers a forced outage and is out of service for the entire month should not be penalized for the 200 MWh declined over the 300 MWh threshold. Mirant recommends that the Commission increase the exemption to 500 MWh, arguing that this should cause no disruption to CAISO's operations or market efficiencies.

2. <u>Commission Determination</u>

27. We find that CAISO's proposed penalty mechanism for minimizing excessive pre-dispatched bid declines reasonably balances market flexibility with the need to maintain reliable grid operations. Specifically, we believe that the proposed 10 percent threshold is high enough at this time so as not to discourage market participants from submitting import and exports bids. Further, CAISO's proposed 10 percent threshold will appropriately accommodate bid declines that are beyond the scheduling coordinator's control, such as curtailments by reliability authorities, derates of transmission lines or generation outages.[21] As discussed below, we will not allow any exemptions to the charge for pre-dispatched bid declines above the 10 percent threshold.

28. In response to SVP/MSR's argument that the Commission should reject CAISO's proposal and instead adopt a reservation fee or premium, we are not persuaded that SVP/MSR's concerns regarding lost opportunity costs exceed the need for discipline in the market. We are also unconvinced that their arguments addressing the physical bilateral market are in fact applicable to CAISO's real-time pre-dispatch market. SVP/MSR's contention that CAISO's proposal will act as a deterrent to bidding is not persuasive. We reiterate that a balance must be struck between limiting the number of declines and ensuring that sufficient energy bids are available to achieve an efficient outcome. We find that CAISO's proposal appropriately achieves this balance. Finally, SVP/MSR provide no evidence to support their assertion that a reservation fee or option payment would result in a better chance of ensuring a reliable stack of dispatchable energy than would CAISO's instant proposal. CAISO has presented a reasonable

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[20] Mirant Protest at 6.

[21] CAISO's analysis shows that, without any incentive in place to minimize declines, a 10 percent threshold would have affected scheduling coordinators supplying 23 percent of incremental energy obtained in the pre-dispatch process for the May 2007 to October 2007 period. We expect that this figure will decrease once CAISO's proposal is implemented and scheduling coordinators face consequences for high levels of pre-dispatched bid declines. *See* CAISO February 2008 Filing at Attachment E.

approach that has been vetted through its stakeholder process and addresses the concerns posed by high levels of pre-dispatched bid declines.

29. We will also not require CAISO to evaluate declines to determine whether they are justified as beyond the scheduling coordinator's control. CAISO indicates that it "does not have sufficient visibility to tally the entire universe of circumstances which are beyond a market participant's control, such as real-time transmission issues in other control areas, even on a post process basis."[22] We agree and find that such a requirement would be unreasonable.

30. Further, we will not require CAISO to lower the monthly threshold from 10 to five percent as PG&E, SoCal Edison and Powerex recommend. In response to Powerex's assertion that CAISO's analysis found that real-time schedule cuts by CAISO itself did not generally result in declines in excess of five percent, we note that this analysis does not include schedule cuts by other transmission providers. While we agree with Powerex that a 10 percent monthly threshold does not directly address the potential reliability concerns associated with excessive declines in a few critical hours when CAISO may urgently need energy, it is not clear whether Powerex's proposed five percent monthly threshold represents a significant improvement. We expect CAISO will continue to monitor the level of pre-dispatched bid declines. If the situation does not improve, we will remain open to further remedies, including a tightening of the threshold, an increase in the level of charges assessed, or a more granular approach to the basis for the threshold.

31. Regarding Dynegy's claim that there exists a misalignment in timing between CAISO's markets and trading in the rest of the West, we find that the Commission has already appropriately addressed this issue in the MRTU proceeding.[23]

32. Finally, with respect to Mirant's argument that the Commission should require a 500 MWh decline threshold instead of CAISO's proposed 300 MWh, we note that CAISO's analysis shows that a 300 MWh threshold has a minimal impact on scheduling

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[22] *See* CAISO Proposal on Declined Real-Time Import and Export Bids, Attachment E, at 3 (Nov. 30, 2007).

[23] *California Independent System Operator Corporation*, 119 FERC ¶ 61,076, at P 219 (2007) (directing CAISO and other control areas to include the status of Western Electricity Coordinating Council efforts to improve scheduling practices in their joint quarterly seams status reports.).

coordinators in the market.[24] We further note that the 300 MWh proposal was developed to accommodate smaller scheduling coordinators and that Mirant, a large scheduling coordinator, has the option to continue bidding for the remainder of the month using other sources.

C. CAISO's Proposed Enforcement Protocol Amendment

1. Comments

33. Dynegy and Powerex assert that while CAISO's proposed additions to section 37.3.1.2 make clear that financial penalties will apply if a market participant's declines exceed a specified threshold, they do not make unambiguously clear what CAISO pledges in its transmittal letter, namely, that the section 11.31 penalties are the only penalties that will apply under section 37.3 for failure to deliver energy on pre-dispatched import or export bids.[25] Dynegy and Powerex do not, however, dispute CAISO's assertion that declines might warrant scrutiny and sanction under another provision of the CAISO's enforcement protocol should the failure to deliver energy be part of some attempt to manipulate the market. Thus, Dynegy suggests that section 37.3.1.2 be revised to add "but shall not be subject to any other Sanction under this section 37.3."[26]

34. SoCal Edison requests that the Commission clarify that the language in section 37.3.1.1, coupled with other anti-manipulation rules, including the prohibition against submitting false information to CAISO remain in full force and prevent participants from submitting energy bids for which they have no intent or reasonable capability of delivering.

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[24] *See* CAISO Proposal on Declined Real-Time Import and Export Bids Attachment E, at 8 (Nov. 30, 2007) (finding that a 300 MWh threshold would have impacted nine of 232 cases of declines for pre-dispatched incremental energy for the October 2006 through November 2007 period).

[25] Dynegy Comments at 5; Powerex Protest at 15.

[26] Dynegy Comments at 6. Powerex also argues that scheduling coordinators that traditionally declined at lower levels but that increase their declines following CAISO's new rules should not be subject to additional scrutiny or sanctions simply because they no longer meet their historical delivery track records. *See* Powerex Protest at 16 (citing *New York Independent System Operator, Inc.* Office of Enforcement – Division of Investigations, Enforcement Staff Report, Findings of a Non-Public Investigation of Potential Market Manipulation by Suppliers in the New York City Capacity Market (Docket Nos. IN08-2-000 and EL07-39-000), at 17 (Feb. 28, 2008)).

2. Commission Determination

35. We agree that CAISO's proposed Tariff amendment filing does not make clear that the section 11.31 penalties are the only penalties that will apply under section 37.3.1.1 for failure to deliver energy on pre-dispatched import or export bids. Further, we note that CAISO's transmittal letter states that the section 11.31 settlement charges "will apply to all pre-dispatched bids that are not delivered for any reason, including dispatches that are declined due to failure to timely submit a valid e-tag…[and that it] has considered and rejected arguments that certain conditions should create exceptions from the charge for particular declined dispatch."[27] However, this language is not replicated in CAISO's proposed Tariff amendment, leaving open the possibility for either exemption to the charge or for further sanction due to violation of the reasonable expectation behavioral standard in section 37.3.1.1. Accordingly, we will direct CAISO to submit a compliance filing clarifying its Tariff language to provide, as stated in its transmittal letter, that no exceptions from the charges in section 11.31 for particular declined dispatches are allowed, and that section 37.3.1.1 on "Expected Conduct" is not applicable (i.e., the section 11.31 charge would be applied solely for purposes of determining that a market participant has not met the decline threshold level and would not mean that a market participant would be subject to some other sanction under CAISO's "Enforcement Protocol"). Finally, we will require that CAISO clarify, on compliance, that the anti-manipulation provisions remain in full force.

The Commission orders:

(A) CAISO's February 29, 2008 Tariff amendment filing is hereby conditionally accepted, effective May 1, 2008, as discussed in the body of this order.

(B) CAISO is hereby directed to submit a compliance filing, consistent with the Commission's findings, as discussed in the body of this order, within 30 days of the date of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

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[27] CAISO February 2008 Filing at 8.